STATE OF MAINE
PUBLIC UTILITIES COMMISSION

August 3, 2004

ORDER

BANGOR GAS COMPANY LLC,
Proposed Cost of Gas Adjustment
Filing

Docket No. 2003-111

BANGOR GAS COMPANY LLC
Proposed Cost of Gas Adjustment
Filing

Docket No. 2003-606

WELCH, Chairman; DIAMOND and REISHUS, Commissioners

I. SUMMARY

We approve Bangor Gas Company LLC's (Bangor Gas or BGC) Fixed Price Option (FPO) proposal for the 6-month period of November 1, 2004 through April 30, 2005 only.[1] Because of our concerns about the design of this option, we require BGC to report no later than July 1, 2005 with an analysis of the program along with its recommendations as to whether this option should be modified, discontinued or remain in place as currently approved.

II. PROCEDURAL HISTORY

On August 8, 2003, pursuant to our April 29, 2003 Order in Docket No. 2003-111, Bangor Gas filed a proposal to reduce the price distorting effects of large under- and over-accruals that result from differences in the actual commodity price of gas paid by Bangor Gas and the price estimated at the start of the 6-month seasonal cost of gas period. Bangor Gas proposed developing a monthly cost of gas adjustment known as the Standard Price Option (SPO) beginning November 1, 2003. Bangor Gas also proposed to offer a Fixed Price Option (FPO) and a Maximum Price Option (MPO) as alternatives for customers, to become available November 1, 2004, subject to customer interest.

The Hearing Examiner granted the Office of the Public Advocate's (OPA) petition to intervene. Maine Natural Gas Corporation (MNG) was allowed limited intervention as a matter of discretion.

In October of 2003, the Commission approved the monthly cost of gas adjustment and a Budget Payment Plan. *Bangor Gas Company LLC, Proposed Cost of*

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[1] Commissioner Diamond dissents from this Order. His separate opinion follows the Order.

Gas Adjustment, Docket Nos. 2003-111 and 2003-606, Order (Oct. 22, 2003). The parties continued to review BGC's other proposals.

On January 30, 2004, a technical conference was held to discuss BGC's revised FPO proposal filed in response to Advisors' Data Request No. 1. In that revision, BGC proposed to withdraw its proposal to offer the Maximum Price Option. It proposed to offer only the Fixed Price Option for the Winter 2004 – 2005 period. Richard Silkman of Competitive Energy Services (CES), an electricity and natural gas marketer in BGC's area, participated in this conference but did not seek to intervene in the proceeding. At the conclusion of this conference, BGC indicated it wished to rethink its FPO and MPO proposals.

On May 20, 2004, BGC filed supplemental testimony of Joseph Cote and Keith Fuller and a modified FPO proposal designed to be responsive to the issues raised at the January 30, 2004 technical conference. On June 9, 2004, an additional technical conference was held to further analyze BGC's proposal.

The Hearing Examiner issued an Examiner's Report on June 23, 2004. BGC filed comments on June 24, 2004 that were largely editorial. OPA filed comments on June 29, 2004 in which it proposed that, should the adverse impact of these risks on SPO customers become anything other than *de minimus*, the FPO plan should be revisited.

Initial deliberations were held on July 1, 2004 but were recessed until the risks and options could be further explored. Staff issued a memo containing the further analysis of Dr. Thomas Austin discussing quantification of the risk of adverse impact of the FPO program on SPO customers and suggesting alternative designs for an FPO program that would avoid these risks. OPA and BGC filed responsive comments. A hearing was held on July 21, 2004, followed by deliberations.

III. DESCRIPTION OF BANGOR GAS REVISED FPO PROPOSAL

Under the BGC's revised FPO, it would offer a FPO for the six-month period November 1, 2004 through April 30, 2005 and for each succeeding winter period. Prior to the enrollment period, BGC proposes to purchase fixed price gas for approximately 33% of its total needs for the upcoming winter period based upon its forecast of bundled sales and internal operational requirements. BGC will then offer an FPO at the price the fixed price gas was obtained plus any reservation charge and other commodity adders allowed by BGC's tariff.

BGC proposes to limit FPO enrollment to 2/3 of the fixed price gas based on the expected gas use of those customers who sign up. The remaining 1/3 of the fixed price gas purchased by BGC for the winter season will first be allocated to FPO usage that exceeds FPO estimated usage. Any remainder will devolve to SPO customers. Thus, if the expected FPO customer usage estimates are correct, 1/3 of the fixed price gas would be allocated to SPO, not FPO customers. However, if actual usage of the FPO customers differs from the estimate, the amount of fixed price gas allocated to SPO customers will be either more or less than 1/3 of the fixed price gas quantity.

BGC will enroll FPO customers on a first-come, first-served basis during September. However, within each customer class (residential, small commercial and large commercial) BGC will limit enrollments to a level at which the expected FPO class usage matches that class's pro rata share of the total fixed price gas available.

To the extent that each customer class is not fully enrolled, BGC will make the remaining quantity of fixed price gas allocated to that class available to other customer classes, starting with the residential customers, during the first week of October. It will maintain a listing of those customers that expressed an interest in enrolling after the class was fully enrolled with the date and time the customer contacted Bangor Gas to ensure that the customers are treated on a first-come, first-served basis.

BGC states that all full service customers will be eligible for the FPO price for the entire seasonal usage, regardless of how much their actual usage exceeds BGC's estimates, with two exceptions. The first exception would be for non-residential class customers that in BGC's opinion have usage profiles that cannot be accurately estimated because of inadequate histories or other factors that render the customer's usage unpredictable. These customers will not be eligible for the FPO option. Second, BGC also proposes to limit the amount of FPO gas available to a large commercial customer to 35% over the initial estimated monthly usage amount. Any usage by that customer that exceeds the 35% threshold would be charged at the SPO price.

To the extent that all of BGC's fixed price gas is not consumed by FPO customers, BGC will use that gas to meet the needs of its SPO customers. To the extent that the FPO customers use more than the FPO gas purchased, that gas will be priced at the FPO price and any differences between the actual gas costs and the cost of fixed price gas will be reconciled to FPO customers in the next FPO period through an FPO past gas cost adjustment. BGC believes that by limiting the FPO enrollment to two-thirds of the total FPO gas purchased it is unlikely that the latter scenario will take place.

In Appendix A, we provide a simple example illustrating the allocation of gas to FPO and SPO customers.

BGC will price gas used in its operations at the SPO price.

IV. ANALYSIS

BGC's FPO proposal entails certain risks and, under the Company's proposal, those risks will be exclusively borne by customers, particularly SPO customers.

One risk to SPO customers results from BGC's plan to contract for fixed price gas in August and then sign up FPO customers during September at the contract price.

If, for example, the price of future gas rises significantly between the August purchase date and September enrollment period, the FPO option will be priced below the current market price and will presumably be very popular with customers. Depending on the level of FPO customer interest and usage levels, the remaining SPO customers could have limited access to low cost gas. On the other hand, if prices drop significantly between the August purchase date and September enrollment period, few customers would likely opt for the FPO plan, leaving SPO customers with a larger amount of higher cost gas.

The second risk to SPO customers also results from FPO customers' priority in the allocation of fixed price gas. For example, if we have an extremely cold winter, FPO customers will presumably use an unexpectedly large quantity of gas. Furthermore, the spot market price of gas is often closely tied to weather conditions, rising during periods of cold weather. The overall effect would be that SPO customers would have correspondingly less (or no) fixed price gas available to them and replacement gas could be relatively expensive.

Finally, the number of customers that can sign up for FPO service is limited so, if the service becomes fully subscribed, some customers seeking to enroll may be turned away.

We have reviewed the rate effects on SPO customers of this proposal and are unable to predict the likelihood of a significant adverse price impact to SPO customers occurring in any particular winter. This is because three largely unpredictable factors – weather, the spot price of gas next winter, and customer decisions -- are key factors in the analysis. The Company's analysis, which used historical data, confirms that in some winters gas portfolio costs for SPO customers would have increased due to allocation of fixed price gas to the SPO gas portfolio, while in other winters the effect of the fixed price gas allocation would have decreased SPO customers' gas portfolio costs. And while we are assured by this analysis that SPO customers will bear some costs of this program, it is difficult to determine the likelihood or the magnitude of these events. Moreover, at the quantity of gas involved, even relatively large changes in gas price and FPO usage level have only a modest impact on SPO customers.

Neither BGC nor the other LDC’s in Maine have had extensive experience with fixed price natural gas offerings, making it difficult to gauge the degree of likely participation by customers. We appreciate the Company's willingness to provide consumers with this pricing option and to actively consider modifications of this program that will resolve the concerns that we have found.[2] We approve the Company’s proposal for this upcoming winter despite our concerns with its design because we believe that such options provide a valuable service to customers seeking price stability.

[2] At the hearing we discussed the possible alternatives, such as: 1) setting a fixed quantity of FPO gas for each FPO customer, 2) including an additional charge to FPO customers for the value of getting a fixed price for an unlimited quantity of FPO gas, and 3) reconciling FPO revenue under-collections in subsequent FPO periods. We also noted that alternatives 2 and 3 could be combined.

We decide to implement an imperfect program now rather than to wait until a better program can be developed, in part, because the rate effect on SPO customers appears to be small at the quantity BGC proposes to purchase. However, in our view any future plan should avoid shifting risk to SPO customers for the benefit of FPO customers. Expansion of this program would be especially problematic because, as the body of enrolled FPO customers and the volume of FPO gas increases relative to the remaining body of SPO customers, the risk of adverse rate impacts to SPO customers would exceed the benefits. Our preference is that BGC replace this program with a program that eliminates sharing the costs of this program with those who do not obtain its full benefits.

To allow us to carefully consider whether this program should continue in successive years, we also require that BGC file an analysis of the results of this program no later than July 1, 2005, including an analysis of the impact of the FPO program on SPO customers. BGC should include with that filing any proposals that it has for modifying, replacing, or abandoning the FPO program.

Accordingly, we

O R D E R

1. That Bangor Gas Company's proposed Fixed Price Option is approved subject to the limitations stated in this Order;

2. That Bangor Gas Company shall file tariffs in compliance with this Order for approval; and

3. That Bangor Gas Company shall report by July 1, 2005 with an analysis of its experience with this program and proposals for modifications to it.

Dated at Augusta, Maine, this 3rd day of August, 2004.

BY ORDER OF THE COMMISSION

Raymond J. Robichaud
Acting Administrative Director

COMMISSIONERS VOTING FOR: Welch
Reishus

COMMISSIONER DISSENTING: Diamond

SEPARATE OPINION OF COMMISSIONER DIAMOND

I dissent from the decision of the Commission. I agree with virtually all of the analysis in the Order, but whereas that analysis leads my colleagues to approve Bangor Gas's fixed-price program for a single winter, with the hope that it will be replaced by an improved version next year, it would lead me to delay implementing the program until the elimination of what I see as very serious flaws.

My major concern is that the program provides the FPO customers with a major benefit the cost of which will be absorbed by the SPO customers. More specifically, the SPO customers will effectively pay the cost of protecting the FPO customers against adverse price consequences if the latter use less or more gas than anticipated. To accomplish this, Bangor Gas will buy 50% more fixed-price supply than is predicted to be needed to serve the FPO customers. To the extent not used by the FPO customers, this gas will be used to supply the SPO customers at the fixed price. If the FPO customers "overconsume," this excess gas provides them with a fixed-price cushion. If they "underconsume," the additional unused gas is added to the excess supply and used to serve the SPO customers at the fixed price.

One might argue that this simply hedges some of the supply used for the SPO customers and that in years when the spot price rises it will benefit them and in years when it falls it will hurt them. The problem is that the hedge will not work in a random fashion. To the contrary, in a cold winter, the FPO customers will likely use more fixed-price gas than anticipated, leaving less for the SPO customers at a time when it is probable that spot prices will be higher. Conversely, in a warm winter, the FPO customers will use less fixed-price gas and more will be dedicated for SPO service just when spot prices are lower. In short, the SPO customers are likely to have less fixed-price gas when it would most benefit them and more fixed-price gas when it is would most hurt them. And they will be subject to this "heads you win, tails I lose" result so that the FPO customers can be protected against volume risk free of charge.

The majority concludes that since the impact of this effect on the SPO customers is not likely to be great at the modest level at which Bangor Gas proposes to operate the program, there is no harm in implementing it for one winter to get a fixed-price option in place. While I share their enthusiasm for the availability of a fixed-price option, I do not see the logic of allowing a fundamentally flawed program to proceed, even on a trial basis. Should there be broad customer support for the fixed-price option, we will be in the ironic position of having a program for which there is great customer demand but which cannot be expanded without becoming unfair to the SPO customers to a degree that the majority appears to agree would be unacceptable. To me, it makes far more sense to get the program right before implementing it.

Appendix A
Illustration of Gas Allocation to FPO and SPO Customers

For purposes of illustration, suppose BGC expected its customers would use 450 Dth of gas. It would purchase 1/3 of this, 150 Dth, under contract as Fixed Price Gas (FPG). It would, at least for illustrative purposes, acquire the remainder of its needs at spot market prices, (SPG). It would also sell, or attempt to sell, 2/3 of its FPG, 100 Dth, to FPO customers. The following chart illustrates the impact several levels of FPO actual sales.

	FPO	FPO Sources		SPO	SPO Sources	
Scenario	Use	FPG	SPG	Use	FPG	SPG
Base Case	100	100	0	350	50	300
Low FPO Use	75	75	0	350	75	275
High FPO Use	150	150	0	350	0	350
Very High FPO Use	200	150	50*	350	0	350

* This SPG gas would initially be charged to FPO customers at the FPO rate but would be reconciled in the subsequent year's FPO rate.